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No. 46

In the Supreme Court of the United States

OCTOBER TERM, 1964

PEOPLE OF THE STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Petitioners,

vs.

LO-VACA GATHERING COMPANY, HOUSTON PIPE LINE COMPANY, and EL PASO NATURAL GAS COMPANY,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

Reply Brief for Petitioners

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In accordance with Rule 41 (3) of the Revised Rules of the Supreme Court of the United States, the petitioners, People of the State of California and Public Utilities Commission of the State of California (California), submit this brief in reply to the joint brief for respondents Lo-Vaca Gathering Company (Lo-Vaca), Houston Pipe Line Company (Houston) and El Paso Natural Gas Compay (El Paso), and in reply to the brief of the Independent Natural Gas Association of America (Association), *amicus curiae*.

ARGUMENT

I. Respondents' Theory of Proportional Separation Is Inconsistent with Physical Fact, Contract Requirements and Effective Regulation

In order for Federal Power Commission (Commission) jurisdiction to attach to the Lo-Vaca and Houston sales it must be recognized that these sales are sales in interstate commerce for resale. Considering not what the contracting parties say about the sales but considering what they actually will do with the gas, the Lo-Vaca and Houston gas will be sold in interstate commerce for resale. This was conceded by Houston's president and El Paso's chief pipeline engineer. (R. 56-57, 66). Consequently, from the point of view of physical fact, the sales are without question subject to the Commission's jurisdiction.

The respondents, while conceding that their gas would flow to interstate markets for eventual resale, would have this Court rest a decision of nonjurisdiction on mere contractual stipulations which purport to "restrict" the Lo-Vaca gas to El Paso's facilities outside of Texas, and to "restrict" the Houston gas to facilities within Texas.

The so-called restrictions do not restrict the physical flow of the gas, or even compel El Paso to handle the Lo-Vaca and Houston supplies differently from other gas within the El Paso system. In fact, the contractual stipulations are not restrictive at all but rather they place an affirmative duty upon El Paso to label some gas consumed outside of Texas "Lo-Vaca gas," to label some gas consumed inside of Texas "Houston gas," and to assure the volumes so consumed at least equal the volumes purchased from Lo-Vaca and Houston. (Joint Br., pp. 35-37).

El Paso is required to pretend that Lo-Vaca and Houston gas is being burned as fuel in certain places, and to pretend that none of the gas is being resold in interstate commerce. But such pretension is a really broad assertion by El Paso of a power to decide whose gas is where at what time in what part of its system

This case involves, then, the power of El Paso to attach, whenever and wherever convenient, the label of a particular seller to a particular load of gas within its system. Respondents would justify this power on the basis of the commercial practice, often related to grain elevators, of proportional separation of fungible commodities by volume. (Joint Br., pp. 32-35). Essentially, respondents argue that any gas tapped from El Paso's system would be equivalent to the Lo-Vaca and Houston gas.

Viewing the matter within the framework of the respondents' own contracts, this position makes little sense. The gas is sold to El Paso by Lo-Vaca and Houston subject to specific quality standards and, as is the industry custom, quality and price are directly rela[1] See *The Pure Oil Co. v. Federal Power Commission*, 299 F.2d 370, 373 (7th Cir. 1962). Yet once the gas is turned over to El Paso for system use, at set prices, there is no assurance that whatever gas El Paso would use for the particular purposes agreed upon would be of the same quality as the Lo-Vaca and Houston gas, or would elicit the same prices as Lo-Vaca and Houston gas in the pipeline market.

The pointlessness of respondents' argument can be demonstrated by assuming that El Paso were not buying the Lo-Vaca and Houston gas but were only transporting the gas within its system as a service to the companies. We may be certain that Lo-Vaca and Houston would demand the return of equivalent gas—in quality as well as volume—at the end of the journey, or would demand at least some price adjustment to reflect any changes.

If Lo-Vaca and Houston were only selling volumes of gas, to be measured when sold to El Paso and to be measured when utilized by El Paso, then all the language in their contracts relating to quality standards would be surplusage. California submits that it is a meaningless gesture to provide quality standards at the points of sale and yet not provide those standards at the points where the gas is theoretically to be consumed. This demonstrates the sheer fantasy of the "restricted-use" stipulations.

Viewing the matter from a regulatory standpoint, acceptance of respondents' theory would produce ridiculous regulatory results. Under this theory gas transferred to El Paso through the unregulated Lo-Vaca and Houston sales would displace gas received by El Paso under regulated sales. Assuming Lo-Vaca and Houston gas to be low quality gas sold at a premium price, El Paso would be in a position to withdraw from its system high quality gas sold at regulated prices and call this "Lo-Vaca gas" and "Houston gas." El Paso's mainstream, destined for resale in interstate commerce, would retain the low quality gas which would, under respondents' theory of proportional separation by volume, represent the gas sold under regulation. The producer who sells his gas in interstate commerce for resale at a regulated price would certainly have cause to complain if the pipeline, after receiving his gas, were able to label it the gas of another seller who sold gas at an unregulated price.

The "restricted-use" stipulations must be recognized as devices designed to enable sellers to sell their gas in interstate commerce for resale and at the same time escape the regulatory jurisdiction which attaches to such sales.

Respondents argue that the only alternative to the "restricted-use" stipulation is the construction of separate facilities to transport nonjurisdictional gas. This is hardly the only alternative. The obvious other alternative would be a jurisdictional sale such as Lo-Vaca proposes under its May contract.*

In a few cases jurisdictional gas and nonjurisdictional gas have been transported in common facilities. See *North Dakota v. Federal Power Commission*, 247 F.2d 173 (8th Cir. 1957), and *City of Hastings v. Federal Power Commission*, 221 F.2d 31 (D.C. Cir. 1954), cert. denied 349 U.S. 920 (1955). In such instances, however, the physical flow of gas must be traced from the point of sale

*Lo-Vaca is, of course, prepared to consummate its sale to El Paso under the March contract even if it is ultimately determined to be subject to the Commission's jurisdiction." (R. 22-23)

to the point of nonjurisdictional use. This factor is completely absent in respondents' transactions. Its importance will be discussed next.

II. Respondents' Scheme of Proportional Separation Is Novel and Unprecedented

Proportional separation by volume of fungible commodities is applied in some cases. In the early case of *Harrington v. United States*, 78 U.S. (11 Wall.) 356, 368-369 (1871), the Court approved a proportional separation by volume of distilled spirits. In *The Intermingled Cotton Cases*, 92 U.S. 651 (1876), the proceeds from the sale of a large, commingled quantity of cotton were divided in proportion to the aliquot interest of each owner in the cotton. These cases, as well as cases cited by respondents involving grain, sugar and coal (Joint Br., p. 34), concerned commodities of like quality, commingled in a fungible mass, where proportional separation was possible on the basis of the interest of each joint owner in the commingled mass. The practice certainly is not an issue in this proceeding.

In *North Dakota v. Federal Power Commission*, 247 F.2d 173 (8th Cir. 1957), and *City of Hastings v. Federal Power Commission*, 221 F.2d 31 (D.C. Cir. 1955), cert. denied 349 U.S. 920 (1955), a proportional separation by volume was permitted because in each case there was a single, fungible supply of natural gas which was realistically divisible into jurisdictional and nonjurisdictional parts.

In *North Dakota* a single supply of gas from the tailgate of a plant in North Dakota was sold and delivered to an interstate pipeline company. The supply was transported in one line with no other gas. This supply of tailgate gas was partly consumed in North Dakota and the remainder was resold outside of North Dakota. The sale representing the tailgate gas consumed in North Dakota was nonjurisdictional because it was not a sale in interstate commerce; the sale representing the tailgate gas resold

in interstate commerce was jurisdictional. In *North Dakota* the nonjurisdictional gas was the same type of gas as the jurisdictional gas because each was a part of a common supply. This common supply could be traced back to the source—the tailgate of the plant where the sales were made.

The *North Dakota* case should be contrasted with the Houston sale. Unlike nonjurisdictional gas in *North Dakota*, which was a separate proportion of the gas sold at the plant, the purported nonjurisdictional gas which would be consumed in Texas under the Houston transaction would not even be traceable to the gas sold at Coquat Station. Unlike the nonjurisdictional gas in *North Dakota*, which was the same type of gas as the gas sold at the plant, the gas sold by Houston at Coquat Station need not even resemble the gas ultimately used by El Paso for nonjurisdictional purposes. Unlike the nonjurisdictional gas in *North Dakota*, which was never commingled with gas from a source other than the plant, the so-called nonjurisdictional gas which would be utilized by El Paso within Texas would be a composite of gases from numerous sources.

California submits that the *North Dakota* case presented a set of facts which made proportional separation by volumes meaningful. On the other hand, the Houston transaction, which would provide no links between the gas sold and the gas utilized in intrastate commerce, presents a set of facts which would undermine the practice of proportional separation.

City of Hastings involved sales of gas by an interstate pipeline company to a city. A single supply of gas, transported in interstate commerce, was delivered to the city. A proportion of this supply was put to a direct industrial use and, therefore, did not involve a sale for resale; the remainder of this supply was resold and, consequently, involved a jurisdictional sale. It is important to emphasis that in *City of Hastings*, as in *North Dakota*, the nonjurisdictional gas was a proportional part of a single supply purchased from the seller.

The *City of Hastings* case should be contrasted with the Lo-Vaca proposal. *City of Hastings* has no application to the Lo-Vaca sale for same reasons that *North Dakota* has no application to the Houston sale. In *City of Hastings* the nonjurisdictional gas was a proportional part of the single supply delivered to the city; the nonjurisdictional gas was identical to the other gas making up the city's supply; and the city's supply was never commingled with gas from another source. On the other hand, the gas which would be utilized by El Paso in its own facilities outside of Texas would not even be traceable to the gas sold at Coquat Station, need not even resemble the gas sold by Lo-Vaca, and would be derived from an unlimited number of sources. Again, while proportional separation by volume was realistic in the *City of Hastings* case, application of the practice to the facts of the Lo-Vaca case would be stretching the concept beyond all practical limits.

The factual distinctions between *North Dakota* and *City of Hastings*, on one hand, and the Houston and Lo-Vaca sales, on the other hand, are material. Did the fact that the pipeline company in *North Dakota* sold gas in intrastate commerce give such pipeline company power to place the label of any one of its many suppliers on such gas and thereby remove the sale by that supplier from the Commission's jurisdiction? Did the fact that the city in *City of Hastings* used some of the gas it purchased for an industrial use alter the fact that the gas came from one pipeline company and no other? The answers are obviously in the negative.

In *North Dakota* and *City of Hastings* the nonjurisdictional use of the gas was a function of a separate, proportional part of the total supply of gas sold. The same was true in *United States v. Public Utilities Commission*, 345 U.S. 295 (1953), also relied upon by respondents, where the electric energy sold for direct consumption, if sold under a separate transaction, would

have been directly traceable to the total supply of energy originally sold to the purchaser.*

A single supply of natural gas can be the subject of both regulated and unregulated sales if the single supply is divisible into parts of the same quality, and these parts can be separated as to use. Physical identification and tracing of molecules, in such a case, would be meaningless because the flow from the point where the gas is sold and delivered would always be traceable to the regulated or the unregulated utilization.

Respondents attempt to draw a parallel between their sales and transportation agreements under which a pipeline company transports someone else's gas for a service fee. In some instances gas so transported may be commingled within the pipeline with gas to be resold in interstate commerce. Such cases have no relevance to the facts involved in the Lo-Vaca and Houston transactions.

The Lo-Vaca and Houston gas is *sold* to El Paso; it is El Paso's property. On the other hand, under a transportation agreement there is no sale to be regulated. While it is possible that under a transportation agreement the owner of the gas may not have the identical molecules returned to him upon completion of the transportation, he still may provide in his agreement that the gas returned to him comes from the same physical flow, that it be gas of the same quality as that originally turned over to the transporter, and that there be an adjustment for any change in quality. The Lo-Vaca and Houston gas is, by contrast, sold to El Paso without a condition, or even a bare assurance that the gas consumed in nonjurisdiction uses will have a resemblance or a relationship to the gas sold.

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*Respondents further rely upon *Amerada Petroleum Corp. v. Federal Power Commission*, 334 F.2d 404 (8th Cir. 1964), a case decided subsequent to the decision of the court below and based on the rationale of that decision. The matter is pending before this Court in *Federal Power Commission v. Amerada Petroleum Corp.*, No. 585 (Oct. Term 1964), on the Commission's petition for a writ of certiorari.

Respondents fail to cite a single example where the Commission has declined to assert jurisdiction over transactions such as they propose. This is understandable because respondents' theory of proportional separation by volume is novel and unprecedented. It is not motivated by business convenience or necessity. It is not motivated by public convenience and necessity. It is motivated by a desire to escape regulation which would otherwise attach to the sales under the physical facts.

III. Respondents' Sales Would Open an Attractive Gap in an Area Now Subject to the Commission's Regulatory Authority

Respondents' attempt to characterize the Commission's effort to regulate their sales as an assertion of jurisdiction in a new area. This characterization evades the real question which is whether or not the respondents' sales come within the Commission's undisputed authority to regulate sales in interstate commerce for resale. There is no question here of new authority but rather a question on the exercise of the Commission's existing authority.

The gap that will be created if the Lo-Vaca and Houston sales are allowed to go unregulated will be a gap within the category of "sales in interstate for resale". With this gap Lo-Vaca, Houston and those similarly situated will be able to sell their gas to pipeline companies for resale in interstate commerce and, by the magic of a few additional words in the contracts, reap the benefits of an unregulated sale. The seller's only obligation is to say the words; the buyer's only obligation is to imagine that the gas bought is burned in certain plants, camps or boilers.

Contractually restricted sales, of the type involved in the case at bar, are repugnant to the comprehensive scheme of regulation envisioned by Congress in passing the Natural Gas Act. There is no question but that the interests of primary concern here are national rather than local; there is no question but that respondents have been motivated by a desire to escape federal regulation.

This proceeding, then, does not involve an extension of regulation but the power of natural gas companies to exclude themselves from regulation by their own devices.

This Court must decide the case in a manner which will best promote a congressional policy directed toward effective, comprehensive regulation in the public interest. Such congressional policy, embodied in the Natural Gas Act, does not countenance "attractive gaps" in the regulatory scheme created by the Act.

CONCLUSION

For the foregoing reasons, as well as for the reasons stated in its Brief for Petitioners, California urges that the judgment of the Court of Appeals be reversed with directions to affirm the orders of the Commission.

Respectfully submitted,

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